Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

W. KENNETH TREGENZA, JAMES E. HAAS, and ERWIN B. SEEGERS, on behalf of themselves and a class of persons similiarly situated,

Petitioners,

v.

GREAT AMERICAN COMMUNICATIONS COMPANY, a Florida corporation, and SHEARSON LEHMAN BROTHERS, INC., a Delaware corporation,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Does the one year statute of limitations applicable to actions brought pursuant to §10(b) of the Securities and Exchange Act and S.E.C. Rule 10b-5 begin to run from the date of actual notice or constructive notice of the facts giving rise to the claim?

LIST OF PARTIES

Petitioners, Plaintiffs:

Kenneth Tregenza

James E. Haas

Erwin B. Seegers, on behalf of themselves and a class of persons similarly situated

Respondents, Defendants:

Great American Communications Company

Shearson Lehman Brothers, Inc.

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
LIST OF PARTIES	ii
TABLE OF AUTHORITIES	v
CITATION TO OPINION BELOW	1
JURISDICTION	2
STATUTE INVOLVED	2
STATEMENT	2
REASONS FOR GRANTING THE WRIT:	
I.	
THE SEVENTH CIRCUIT'S DECISION IS AT ODDS WITH THIS COURT'S DECISION IN *LAMPF, PLEVA, LIPKIND, PRUPIS & PETIGROW v. GILBERTSON*, 115 L.Ed.2d 321 (1991).	6
II.	
THIS COURT SHOULD RESOLVE THE CONFLICT IN THE CIRCUITS AS TO WHETHER THE ONE YEAR PERIOD IN *LAMPF* RUNS FROM ACTUAL NOTICE OF THE FACTS OR FROM THE DATE OF "INQUIRY" NOTICE..	9
CONCLUSION	10

APPENDIX

	App. Page
Panel Opinion of the United States Court of Appeals for the Seventh Circuit	1
Judgment Order of the United States Court of Appeals for the Seventh Circuit	11
Memorandum Opinion and Order of the United States District Court for the Northern District of Illinois, Eastern Division	12

TABLE OF AUTHORITIES

Cases	PAGE
Anixter v. Home-Stake Production Co., 939 F.2d 1420 (10th Cir. 1991), *on rehearing* 977 F.2d 1549 (10th Cir. 1992)	9
Gruber v. Price Waterhouse, 911 F.2d 960 (3rd Cir. 1990)	9
In re Data Access Systems Securities Litigation, 843 F.2d 1537 (3rd Cir. 1987)	9
Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. ____, 115 L.Ed. 2d 321 (1991)	6, 7, 8, 9
Menowitz v. Brown, 991 F.2d 36 (2nd Cir. 1993)	9
Westinghouse Electric Corporation v. Franklin, 993 F.2d 347 (3rd Cir. 1993)	9

Statutes	
15 U.S.C. §77k (1988)	7
15 U.S.C. §78i(e) (1988)	2, 7
15 U.S.C. §78j(b) (1988)	2, 7

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PETITION FOR WRIT OF CERTIORARI

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this cause on December 23, 1993.

CITATION TO OPINION BELOW

The panel opinion of the Court of Appeals is reproduced in the Appendix at pp. 1-11 and is reported at 12 F.3d 717 (7th Cir. 1993).

JURISDICTION

The panel opinion was entered on December 23, 1993. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

STATUTES INVOLVED

The statutory provisions involved are §§9(e) and 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §§78i(e) and 78j(b) (1988).

STATEMENT

The Sale of GACC Stock and Its Price Decline

In October 1987, Great American Communications Company ("GACC") purchased Taft Broadcasting Company from its shareholders for $1.5 billion. GACC financed the purchase by selling $560 million of notes, borrowing $670 million from banks and issuing 2.7 million shares of its common stock to Taft shareholders. Faced with enormous debt service obligations from all of its borrowings and poor cash flow, GACC determined to reduce its existing debt by issuing new stock. GACC did not, however, want to sell its shares through a public offering because of the extensive financial disclosures that would have entailed. Instead, GACC met with representatives of Shearson-Lehman Brothers, Inc. ("Lehman") to devise a strategy to raise funds without a public offering.

The resulting fundraising plan first called for Lehman to arrange for GACC to repurchase from GACC's creditors a total of $49.4 million in face amount of debt for $40 million. To raise the funds GACC needed for the debt repurchase, Lehman pre-sold 3.65 million new shares of GACC's unregistered stock to the public on October 11, 1989 at a gross sales price of approximately $45 million, *i.e.*, $12.50 per share. That is, Lehman's brokers solicited purchase orders in advance of the sale date. As an incentive to sell the stock, Lehman brokers received $1 per share commission. Investors were not informed that the GACC stock was newly issued and unregistered or that it was being touted by Lehman brokers because they were receiving an unusually large commission. Investors also were not told that the stock was being sold as part of a plan to retire debt. On October 12, 1989, having presold the entire block of unregistered stock, Lehman gave GACC the cash, which was then used to retire the $49.4 million in debt.

To persuade the public to purchase the unregistered stock, Lehman and GACC devised a misleading and incomplete script. It contained the following false and misleading statements:

(i) That the value of GACC's assets far exceeded the current selling price of the stock and that within two years the stock should be well into the "$20's" when, in fact, the price of the GACC stock was grossly inflated and the assets were worth substantially less than as represented;

(ii) That "the downside risk at the current price level is less than 10%" when, in fact, GACC was so debt-ridden that an investment in GACC stock at any price was extremely risky and highly speculative;

(iii) That Mario Gabelli and Michael Steinhardt, prominent names in the investment community, each had stakes in GACC of between 50,000 and one million shares, thereby implying that these individuals had recently purchased GACC stock when, in fact, the stock which these individuals held was stock they had received in exchange for their Taft Broadcasting stock when GACC purchased Taft in 1987.

Following GACC's $49 million debt repurchase on October 12, 1989, the price of GACC stock declined and continued to do so until it reached $2 per share in October, 1990. During this decline, Lehman continued to tout the stock, stating that the high asset value of the company made the stock far more valuable than the existing market price. According to Lehman, these valuable assets, including Hanna Barbera (a cartoon company), were going to be sold to reduce outstanding debt and improve operating cash flow. Lehman also informed its customers that Carl Linder, one of the wealthiest men in the country and GACC's chairman and largest shareholder, was "standing behind" GACC and would support the stock's price. In addition, Lehman brokers compared GACC favorably with major media corporations such as ABC and CBS.

Plaintiff Tregenza's Purchase of Unregistered Stock in October 1989

On October 11, 1989, after listening to the script described above, plaintiff Tregenza purchased 1000 shares of GACC common stock from Lehman for $12.50 per share. Tregenza was not aware of any of the Lehman misstatements and omissions and did not learn of them until 1992. After his purchase, and after the stock was declining, he had further conversations with Lehman regarding GACC and was told not to be concerned because the stock was

still worth far more than its market price due to GACC's high "asset value." Because Lehman continued to tout GACC, in February, 1990, Tregenza purchased an additional 1000 shares of GACC stock at a price of about $8.62 per share. He did not suspect fraud in connection with his GACC transactions until March, 1992, when his Lehman broker told him about a rumored conspiracy among Lehman, GACC and certain short sellers to manipulate GACC's stock price.

Plaintiffs Seegers' and Haas' Open Market Purchases

Plaintiffs Seegers and Haas purchased GACC stock several times between 1989 and December of 1991 in reliance on the post-October 1989 script given by Lehman to its brokers. Neither Seegers nor Haas suspected that the steady drop of GACC's stock prices was fraud-related until they read a report in February, 1992 in *Equities Magazine*, which also suggested that Lehman and GACC had artificially manipulated the price of GACC stock starting in October, 1989. After reading this article, Seegers and Haas began their investigation into the fraud that led to the filing of this lawsuit.

On September 30, 1992, some seven months after their suspicions were aroused, Tregenza, Seegers and Haas filed suit against GACC and Lehman, alleging in substance that the defendants had sold GACC common stock at artificially high prices based upon certain material misstatements and omissions. Plaintiffs stated claims under §10(b) and Rule 10(b)-5 of the Securities and Exchange Act of 1934 and §12(2) of the Securities Act of 1933. Defendants moved for summary judgment on the ground that plaintiffs' claims were time barred. On April 30, 1993, the dis-

trict court granted that motion, concluding that despite Lehman's continued efforts to allay any concern about GACC's stock, plaintiffs were on inquiry notice of their claims by October, 1990 when the stock had dropped to $2 a share.

The United States Court of Appeals for the Seventh Circuit affirmed the lower court's dismissal. Noting (incorrectly) that this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. ____, 115 L.Ed.2d 321 (1991), adopting one year and three year limitations periods, had left open the issue of whether actual or inquiry notice triggered the beginning of the one year period, the Seventh Circuit held that the one year limitation period that applies to §10(b) claims runs from the time a plaintiff is on inquiry notice and that plaintiffs here were on inquiry notice as of October of 1990 because of the drop in GACC's stock price.

REASONS FOR GRANTING THE WRIT

I.

THE SEVENTH CIRCUIT'S DECISION IS AT ODDS WITH THIS COURT'S DECISION IN *LAMPF, PLEVA, LIPKIND, PRUPIS & PETIGROW v. GILBERTSON*, 115 L.Ed.2d 321 (1991).

In their decisions, the lower courts each held the one year limitations period applicable to §10(b) claims begins to run from the date an investor is put on inquiry notice. This date is defined by the Seventh Circuit as the earliest date on which the investor could reasonably suspect that there might have been something amiss when the stock transaction at issued occurred. Here, both courts con-

cluded that the investors were on inquiry notice in October, 1990 based solely on the fact that the price of GACC had fallen from $12.50 to $2 in the prior year. In adopting inquiry notice as the test, the lower court and the court of appeals overlooked the plain language of this Court's decision in *Lampf* that the one year period runs from the date of discovery of the facts. There is no question that actual notice of the wrongs occurred no earlier than March, 1992, which is less than a year prior to the filing of suit.

In *Lampf*, this Court adopted one year and three year limitations periods for claims brought pursuant to §10(b) of the 1934 Act. In so doing, it stated that the one year period runs from the date of discovery:

> "The one year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary."

115 L.Ed.2d at 336.

To remove any doubt on this point, this Court specifically adopted the language of the limitations period set out in §9(e) of the 1934 Act, which is as follows:

> "No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation."

15 U.S.C. §78i(e) (1988).

That this Court meant that the one year period does not begin to run until an investor has actual notice of the facts giving rise to his claim, and not merely inquiry notice, is plain from this Court's decision not to choose the limitations period from §13 of the 1933 Act, 15 U.S.C. §77k (1988). Section 13's one year period begins: "after discovery of the untrue statement or omission, or after

such discovery should have been made by the exercise of reasonable diligence. . . ." If this Court had intended to adopt an inquiry notice standard, it would have done so and adopted the language of §13, which is cited and quoted in the *Lampf* decision, 115 L.Ed.2d at 334, fn.7. This Court instead chose §9(e) with its actual notice requirement:

> "Litigation instituted pursuant to §10(b) and Rule 10b-5 therefore must be commenced within one year after discovery of the facts constituting the violation."

115 L.Ed.2d at 336.

The unfairness of an "inquiry notice" test such as the one adopted by the Seventh Circuit, especially one which holds that notice arises whenever a stock's price drops, is readily apparent. In this case the plaintiffs filed suit within a relatively few months after it became apparent from the *Equities Magazine* article which, if believed, led them to think that they had been misled. Until that time, they had reason to believe the stock price drop was temporary, based upon Lehman's continuing misstatements about the value of stock. Lehman, on the other hand, by falsely lulling the plaintiffs into in action for approximately sixteen months, seeks to avoid liability for its misconduct, and to be rewarded for its further misstatements.

II.

THIS COURT SHOULD RESOLVE THE CONFLICT IN THE CIRCUITS AS TO WHETHER THE ONE YEAR PERIOD IN *LAMPF* RUNS FROM ACTUAL NOTICE OF THE FACTS OR FROM THE DATE OF "INQUIRY" NOTICE.

The Seventh Circuit's ruling that inquiry notice triggers the running of the statute of limitations is at odds with holdings in the Third Circuit. The Third Circuit has construed *Lampf* to mean that the one year period begins to run from actual notice. In two pre-*Lampf* decisions—*In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3rd Cir. 1987) and *Gruber v. Price Waterhouse*, 911 F.2d 960 (3rd Cir. 1990)—the Third Circuit reasoned that the limitations periods set out in other 1934 Act causes of action, including §9(e), are most analogous to a §10(b) cause of action. These decisions therefore held, in accordance with the language of §9(e), that the one year period runs from the date of actual notice of the facts giving rise to the fraud. In *Westinghouse Electric Corp. v. Franklin*, 993 F.2d 347, 352, 356 (3rd Cir. 1993), the Third Circuit concluded that its pre-*Lampf* decisions were consistent with *Lampf*.

The Second and Tenth Circuits, however, agree with the Seventh. See *Menowitz v. Brown*, 991 F.2d 36, 41 (2nd Cir. 1993) and *Anixter v. Home-Stake Production Co.*, 939 F.2d 1420 (10th Cir. 1991), *on rehearing*, 977 F.2d 1549 (10th Cir. 1992). Each of these cases decided that the term "discovery" as it is used in the 1934 Act statutes of limitations includes both inquiry notice and actual notice.

It is important to resolve this conflict. Congress intended uniformity in the construction and application of the federal securities laws, as this Court noted in reaching its decision in *Lampf*. 115 L.Ed. at 331, 332. That the out-

come of an investor's claim based upon the same set of facts should differ from Circuit to Circuit defeats the uniformity Congress and this Court have intended.

CONCLUSION

For the reasons set forth above, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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March 23, 1994

APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 93-2341

W. KENNETH TREGENZA, JAMES E. HAAS, and ERWIN B. SEEGERS,

Plaintiffs-Appellants,

v.

GREAT AMERICAN COMMUNICATIONS COMPANY and SHEARSON LEHMAN BROTHERS, INCORPORATED,

Defendants-Appellees.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 92 C 6384—**William T. Hart**, *Judge.*

ARGUED NOVEMBER 8, 1993—DECIDED DECEMBER 23, 1993

Before POSNER, *Chief Judge*, and BAUER and EASTERBROOK, *Circuit Judges.*

POSNER, *Chief Judge.* Section 9(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(e), requires that suits to enforce the substantive provisions of section 9 be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." The Supreme Court has held that section 9(e) supplies, as well, the statute of limitations (more properly called, in the case of the three-year cutoff, a statute of repose) for suits brought under the SEC's Rule 10b-5,

which was promulgated under section 10(b) of the Act, 15 U.S.C. § 78j(b), a section that contains no statute of limitations. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991). Of course section 9(e) is confined by its terms to suits under section 9, but the Supreme Court has long "borrowed" limitations periods for federal statutes lacking them from other statutes, federal or state, and that is what it did in *Lampf*.

We must decide whether the one-year statute of limitations in section 9(e) begins to run when the victim of the alleged fraud became aware of facts that would have led a reasonable person to investigate whether he might have a claim ("inquiry notice"), or not until he became aware that he was, in fact, a victim of fraud ("actual knowledge"). The issue was not addressed in *Lampf*, and as the opinion contains dicta pointing both ways, compare 111 S. Ct. at 2777 n. 2 with *id.* at 2782 n. 9, not much help can be got from it. The district judge, in accordance with all the appellate holdings on the question, e.g., *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993) (per curiam); *Anixter v. Home-Stake Production Co.*, 947 F.2d 897, 899 (10th Cir. 1991), vacated on different grounds under the name *Dennler v. Trippet*, 112 S. Ct. 1658 (1992), held that inquiry notice sets the statute running and that the plaintiffs had such notice no later than October 1990—making their suit, filed in September 1992, untimely.

The judge held in the alternative that the suit must be dismissed because the plaintiffs had failed to plead in their complaint facts demonstrating the timeliness of the suit. There are cases, in fact securities cases, that say this. E.g., *Davidson v. Wilson*, 973 F.2d 1391, 1402 n. 8 (8th Cir. 1992); *Anixter v. Home-Stake Production Co., supra*, 939 F.2d at 1434; *Cook v. Avien, Inc.*, 573 F.2d 685, 695 (1st Cir. 1978). And it has the support of the redoubtable Louis Loss. 10 Louis Loss & Joel Seligman, *Securities Regulation* 4501-02 (3d ed. 1993). The cases give no reason for the rule; nor does the Loss treatise; and the rule makes no sense that we can see. The statute of limitations is an

affirmative defense, and a plaintiff is not required to negate an affirmative defense in his complaint. *Gomez v. Toledo*, 446 U.S. 635, 640 (1980). Of course if he pleads facts that show that his suit is time-barred or otherwise without merit, he has pleaded himself out of court. *Early v. Bankers Life & Casualty Co.*, 959 F.2d 75, 79 (7th Cir. 1992); *Bartholet v. Reishauer A.G.*, 953 F.2d 1073, 1078 (7th Cir. 1992). But it does not follow from the fact that a plaintiff can get into trouble by pleading more than he is required to plead that he is required to plead that more.

The authorities we have cited invoke the archaic rule that in the case of common law claims the statute of limitations merely limits the remedy, while in the case of statutory claims it limits or defines the substantive right; it is an element of the claim itself. Thomas E. Atkinson, "Pleading the Statute of Limitations," 36 *Yale L.J.* 914, 926 (1927). This is a conclusion rather than an explanation, and an especially dubious one where as in this case the statute of limitations isn't even found in the statute that creates the substantive right. Atkinson, the last person as far as we know to analyze the issue, gives only two reasons for the old rule that are not merely restatements of the rule itself: that statutory claims are disfavored, which was probably true in 1927 but is certainly false today; and that because tolling principles do not apply to statutes of limitations governing statutory claims, it is efficient to permit judges to dispose of untimely statutory claims on demurrer (the 1927 version of the motion to dismiss for failure to state a claim). Once again, whatever the situation may have been more than half a century ago, today tolling principles apply to statutory claims to the same extent as to common law claims. They do not apply to statutes of repose, but a statute of repose is as likely to cut off a common law claim, for example a products liability claim, as a statutory one. A complaint that on its face reveals that the plaintiff's claim is barred by a statute of limitations or repose can be dismissed on a motion to dismiss, in accordance with the principle noted above that a plaintiff can plead himself out of court; and

if the suit is not vulnerable to such disposition only because the complaint omits the date at which the statutory period began to run, the defendant can supply that fact by an affidavit attached to his motion to dismiss. The motion will then be treated as a motion for summary judgment, Fed. R. Civ. P. 12(b), 56, and if the date is uncontestable and no tolling rule is possibly applicable, the suit will be dismissed in the blink of an eye. Of course we are describing the procedure under the Federal Rules of Civil Procedure, which were not in effect in 1927.

Old rules sometimes accrete new rationales as the original rationales fall to changed circumstances. But that is not the case with respect to the old rule that compliance with the statute of limitations is an element of a statutory claim. To the extent that the rule has persisted, it has done so by blind inertia. It is time that it was discarded, and though a case in which the application of the rule would not affect the outcome is not the occasion for the formal obsequies, we shall not rely on it as a possible ground for the dismissal of this suit. Instead we turn to the district judge's first ground, that the statute of limitations applicable to a suit under Rule 10b-5 starts to run when the plaintiff is put on inquiry notice and that by this criterion the present suit is untimely.

As the suit was dismissed on summary judgment, we construe the facts—without of course vouching for the construal—as favorably to the plaintiffs as the record will permit. In October 1987, defendant Great American Communications Company purchased Taft Broadcasting Company for $1.5 billion, taking on heavy debt to finance the purchase. Two years later, to reduce its debt, it arranged with Shearson Lehman Brothers, Inc. for the latter to sell to the public several million new shares of GACC common stock and use the proceeds to retire debt. Lehman's brokers received a generous commission—$1 per share of stock, the sale price being only $12.50. The fact that the proceeds were being used to retire debt was not disclosed publicly until sometime after October 12, 1989, when the sale was complete. Not until February 1992 did

the public learn (through a magazine article) that Lehman had been lending large blocks of GACC stock to short sellers, who were of course banking on the stock's falling in value. The short seller borrows stock from a broker, who sells it, and later the seller buys the stock—he hopes at a lower price—and returns it to the broker to clear the loan.

In collaboration with GACC, Lehman devised a "script" for its brokers to use in selling the stock to an unsuspecting public that included the three plaintiffs in this case. The script called for the brokers to tell prospects that the stock was greatly undervalued and within two years its price should be well above $20; that the stock's downside risk at its current price level of $12 to $12.50 was less than 10 percent, which we suppose meant that there was no appreciable risk that the stock would decline more than 10 percent from its current level before beginning or resuming its ascent into the stratosphere; and that prominent investors held large blocks of GACC stock, implying that it was a promising investment. In fact, the complaint alleges, the price of the stock was grossly inflated, the downside risk was huge because the company was so burdened with debt, and prominent investors held large blocks of GACC stock only because they had received them in exchange for their stock in Taft Broadcasting Company when GACC had bought Taft two years earlier.

Immediately after the sale of the stock on October 12, 1989, its market price began what the plaintiffs describe as "a slow, steady decline." It was steady, all right—indeed inexorable. By October of the following year the price had fallen to $1.50. Later it fell below $1. It has never come back up. As its price tumbled, the plaintiffs called their Lehman brokers to find out what they should do. The brokers reassured them that the stock was a great investment, that a major investor was standing behind it, that GACC was comparable to media giants such as ABC and CBS, and that it would be able to retire debt and recover profitability by selling some of its valuable assets, such as its Hanna-Barbera subsidiary, at a high

price. GACC announced that it was seeking between $350 and $400 million for Hanna-Barbera, but in fact sold it for only $255 million. That was on December 4, 1991. On December 17 Lehman issued an internal memorandum to its brokers instructing them to refrain from further transactions in GACC stock.

The plaintiffs argue that if (contrary to their main submission) section 9(e) embodies a concept of inquiry notice, the one-year statute of limitations began to run no earlier than December 4, 1991, when the disappointing sale of Hanna-Barbera took place, and perhaps not until December 17, 1991. The later date for the onset of notice is plainly unacceptable, however, since the plaintiffs do not suggest that they knew about Lehman's memorandum to its brokers.

If inquiry notice is not the test under section 9(e)—if actual knowledge of the fraud is the test—the plaintiffs say that the year within which they had to file their suit began in February 1992, when Lehman's involvement in the short selling of the stock it was touting was revealed. This choice of the date on which the plaintiffs acquired actual knowledge of fraud is only plausible. If after touting the stock as a great buy and inducing its customers to buy it, Lehman lent the stock (held in brokerage accounts) to short sellers—believers that it was overpriced—maybe an inference arises that Lehman had never really believed the stock was a good buy. But the inference is weak. The fact that other market participants thought the stock overpriced and were willing to put their money where their mouth was sheds little or no light on what Lehman thought.

However all this may be, the plaintiffs were put on inquiry notice much earlier, and indeed not later than October 1990, almost two years before they sued. By that time a stock which they had been told a year earlier was greatly undervalued and would soon be worth twice as much and at worst would not fall by more than 10 percent had lost almost 90 percent of its value. This did not *prove* fraud. Lehman might have believed reasonably and in good faith, though erroneously, that the stock

was undervalued, and probably no reasonable investor would have taken Lehman's representations as an actual *warranty* that the stock would not decline in value by more than 10 percent and would soon double in value. No reasonable investor would think that a stock's value can move in only one direction. But such an investor would have become suspicious and investigated when Lehman's emphatic and precise prediction was so swiftly and dramatically falsified. *Hupp v. Gray*, 500 F.2d 993, 995, 997 (7th Cir. 1974); compare *In re Ames Department Stores, Inc. Note Litigation*, 991 F.2d 968, 979-80 (2d Cir. 1993).

If Lehman had made lulling noises, designed to allay the investors' concerns, the plaintiffs might have been able to arrest the running of the statute of limitations by pleading equitable estoppel. *Singletary v. Continental Illinois National Bank*, No. 93-1849, slip op. at 8-9 (7th Cir. Nov. 16, 1993). *Lampf* holds, it is true, that when knowledge or notice is required to start the statute of limitations running, there is no room for equitable *tolling*. 111 S. Ct. at 2782. But there may still be room in such a case for equitable *estoppel*. *Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1055 (2d Cir. 1969) (Friendly, J.), holds that there is room; *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385, 1392 (7th Cir. 1990), leaves the question open. Equitable tolling just means that without fault by either party the plaintiff does not have enough information to sue within the period of limitations, and in the type of statute of limitations that we are discussing the period of limitations doesn't start until he has the information, making equitable tolling redundant. But the plaintiff might have the required information—actual knowledge of the violation or inquiry notice, as the case may be—yet be thwarted from suing in time by misrepresentations or other actions by the defendant; for example, the defendant might have promised not to plead the statute of limitations. *Schroeder v. Young*, 161 U.S. 334, 344 (1896). But we do not understand the plaintiffs to be arguing equitable estoppel. Their argument is that the statute of limitations did not begin to run until they had actual knowledge of the defendants' fraud, whenever exactly that was.

Section 9(e), read literally, requires actual knowledge to set the statute of limitations running. The plaintiff must know "the facts constituting the violation," not merely enough facts to make a reasonable person suspicious and start looking for the facts constituting the violation. On the same day that section 9(e) was enacted, Congress amended section 13 of the Securities Act of 1933, 15 U.S.C. § 77m, the Act that prohibits fraud in new issues of securities (Securities Act of 1933, §§ 11, 12(2), 15 U.S.C. §§ 77k, 77*l*(2))—and, we have held, in the aftermarket as well, *Pacific Dunlop Holdings Inc. v. Allen & Co.*, 993 F.2d 578 (7th Cir. 1993)—to make the limitations and repose periods the same as those of the Securities Exchange Act of 1934. But section 13 bars suit "unless brought within one year after the discovery of the untrue statement or the omission *or after such discovery should have been made by exercise of reasonable diligence.*" 15 U.S.C. § 77m (emphasis added). And the Supreme Court held in *Lampf* that it is section 9(e) of the 1934 Act, not section 13 of the 1933 Act, that supplies the statute of limitations for Rule 10b-5 suits.

When section 9(e) was enacted in 1934, there was no Rule 10b-5. The substantive provisions of section 9 prohibited (and prohibit) actions by brokers and others to manipulate securities prices, as by creating an appearance of active trading by sales that do not transfer beneficial ownership. Congress could not have known when it enacted section 9(e) that this section would someday provide the statute of limitations for a wide range of securities frauds unrelated to the market manipulations forbidden by section 9. The fact that Congress did not bother to specify inquiry notice need signify no more than that no one foresaw that the absence of such a provision would cause problems with respect to the particular misconduct singled out for prohibition in section 9. It is an impermissible leap to infer that Congress *decided* that inquiry notice should not be a feature of suits brought to enforce the as yet unforeseen Rule 10b-5. Legislatures are not omniscient, and they even know that they are not omni-

scient—for statutes of limitations characteristically omit extensive, and often any, provision for accrual and tolling, leaving those things to be worked out by the courts. Rules making the accrual date the date of discovery, of which actual knowledge and inquiry notice are variants, usually are judicial grafts. Even sixty years ago, when the federal securities laws were enacted, these grafts were common. *Curtis v. Connly*, 257 U.S. 260, 264 (1921) (Holmes, J.). When Congress knew it was dealing with a statute of limitations for fraud, as in section 13 of the 1933 Act, it took care to provide for inquiry notice explicitly. But that does not mean that it intended to prevent the courts from grafting such a provision onto a statute of limitations that lacked it, should that statute of limitations someday become applicable to fraud cases.

Sections 11 and 12(2) of the 1933 Act, on the one hand, and Rule 10b-5 under the 1934 Act, on the other, differ only in details. *Short v. Belleville Shoe Mfg. Co.*, *supra*, 908 F.2d at 1390; *Pacific Dunlop Holdings Inc. v. Allen & Co.*, *supra*, 993 F.2d at 594; *Eckstein v. Balcor Film Investors*, No. 92-1851 slip op. at 2-3 (7th Cir. Aug. 20, 1993). If, as Congress plainly believed, inquiry notice makes sense for fraud in the sale of stock, it makes sense when the fraud is challenged under the rule rather than under the statutes. It is not, we repeat, as if Congress decided to distinguish between the two forms of claim so far as the limitations period was concerned. It did not know that section 9(e) of the 1934 Act would someday be applicable to the same type of fraud claim for which section 13 of the 1933 Act supplied the limitations period.

The precise question, then, is not: Does section 9(e) incorporate the rule of inquiry notice? It is: Are courts free to apply to the section the judge-made doctrine of inquiry notice, long applied in fraud cases outside as well as inside the securities field? E.g., *Stearns v. Page*, 48 U.S. (7 How.) 819, 829 (1849); *Pearsall v. Smith*, 149 U.S. 231, 234-35 (1893); *Teall v. Schroder*, 158 U.S. 172, 177 (1895); *Curtis v. Connly*, *supra*, 257 U.S. at 264; *Holmberg v.*

Armbrecht, 327 U.S. 392, 397 (1946); *Hilton v. Mumaw*, 522 F.2d 588, 595 (9th Cir. 1975). Nothing in the language, history, or purpose of section 9(e) forecloses so modest and traditional an exercise of judicial creativity. It is traditional in securities law as well as in other fields. Besides the cases cited earlier that construe section 9(e) as we do today, *Goldenberg v. Bache & Co.*, 270 F.2d 675, 681 (5th Cir. 1959), placed the same interpretation on section 29(b) of the 1934 Act, which is similarly worded. A third statute of limitations in the 1934 Act, section 18(c), is also similarly worded—and in *Menowitz v. Brown*, *supra*, 991 F.2d at 41, received the same interpretation that has been placed on 9(e) and 29(b). See also *Kahn v. Kohlberg, Kravis, Roberts & Co.*, 970 F.2d 1030, 1042 (2d Cir. 1992).

The utility of inquiry notice and hence the propriety of our interpretation may seem diminished by the presence of a three-year statute of repose. Not so—for section 13 of the 1933 Act has the same three-year statute of repose yet Congress wrote inquiry notice into the one-year statute of limitations in that section. Three years is an age in the stock market. If the suspicious investor had a wide choice of times at which to sue within a three-year period rather than being required to sue no more than one year after the earliest possible date, the opportunistic use of federal securities law to protect investors against market risk would be magnified. These plaintiffs waited patiently to sue. If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages. Heads I win, tails you lose. This tactic is discouraged by the doctrine of inquiry notice, which we hold is applicable in Rule 10b-5 suits.

There are other issues, but they are academic in light of this ruling.

AFFIRMED.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT – WITH ORAL ARGUMENT

Date: December 23, 1993

BEFORE:

Honorable Richard A. Posner, Chief Judge
Honorable William J. Bauer, Circuit Judge
Honorable Frank H. Easterbrook, Circuit Judge

No. 93-2341

W. KENNETH TREGENZA, JAMES E. HAAS, ERWIN B. SEEGERS, on behalf of themselves and a class of persons similarly situated,

Plaintiffs-Appellants

v.

GREAT AMERICAN COMMUNICATIONS COMPANY, a Florida corporation and SHEARSON LEHMAN BROTHERS, INCORPORATED, a Delaware corporation,

Defendants-Appellees

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 92 C 6384, William T. Hart, Judge

The judgment of the District Court is AFFIRMED, with costs, in accordance with the decision of this court entered on this date.

(1061-110393)

[Dated April 30, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 92 C 6384

W. KENNETH TREGENZA, JAMES E. HAAS and ERNEST B. SEEGERS, on behalf of themselves and a class of persons similarly situated,

Plaintiffs,

v.

GREAT AMERICAN COMMUNICATIONS COMPANY, a Florida corporation, and SHEARSON LEHMAN BROTHERS, INC., a Delaware corporation,

Defendants.

MEMORANDUM OPINION AND ORDER

Plaintiff, W. Kenneth Tregenza, is a resident of the state of Michigan who purchased shares of defendant, Great American Communications Company ("GACC") from defendant Shearson Lehman, Inc. ("Lehman") on October 11, 1989. Plaintiff, James E. Haas, is also a Michigan resident who purchased GACC shares through Lehman between November 15, 1989 and November 2, 1991. Plaintiff, Ernest B. Seegers, is a resident of Illinois who purchased shares of GACC through Lehman between November 10, 1989 and June 10, 1991. Defendant, GACC, is a Florida corporation which owns and operates television and radio stations and produces animated television programs and feature films. GACC's principal operations are conducted through Great American Broadcasting Com-

pany in Cincinnati, Ohio. Defendant, Lehman, is a Delaware corporation with its principal place of business in New York. Lehman Brothers is a division of Lehman that maintains retail brokerage sales offices in Chicago, Illinois.

Plaintiffs bring their amended class action complaint pursuant to Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10b-5, and Section 12(2) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 771(2). This court has subject matter jurisdiction under § 27 of the Exchange Act, 15 U.S.C. § 78aa, 28 U.S.C. § 1331, and 28 U.S.C. § 1367. Plaintiffs' supplemental state claims allege violation of the Illinois Securities Law of 1953, Ill. Rev. Stat., ch. 121½, §§ 137.1 *et seq.*, and negligent misrepresentation.

Lehman has filed a motion to dismiss plaintiffs' amended complaint in its entirety for failure to state a claim and because the federal claims were filed beyond the statute of limitations. Fed. R. Civ. P. 12(b)(6). GACC has also filed a motion to dismiss for failure to state a claim, for failure to plead fraud with particularity, Fed. R. Civ. P. 9(b), and on statute of limitations grounds. Because defendants rely on documents outside their pleadings, the court notified the parties at the time the motions were presented that it would treat defendants' motions to dismiss on statute of limitations grounds as motions for summary judgment. *See* Fed. R. Civ. P. 12(b) (last sentence).

On a motion to dismiss, all well-pleaded factual allegations are accepted as true and are construed in favor of claimants. *Roots Partnership v. Lands' End, Inc.*, 965 F.2d 1411, 1416 (7th Cir. 1992). "Dismissal of the complaint is proper only if it appears beyond doubt that the plaintiff[s] can prove no set of facts in support of [their] claim[s] which would entitle [them] to relief." *Id.* The stan-

dard for summary judgment is similar but allows examination of materials outside the complaint. On a motion for summary judgment, the entire record is considered with all reasonable inferences drawn in favor of the nonmovant and all factual disputes resolved in favor of the nonmovant. *Visser v. Packer Engineering Assoc., Inc.*, 909 F.2d 959, 960 (7th Cir. 1990). Summary judgment is appropriate only where there is "no genuine issue as to any material fact." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). Whether or not a fact is material is governed by substantive law. *Id.* The burden of establishing a lack of any genuine issue of material fact rests on the movant. *Jakubiec v. Cities Service Co.*, 844 F.2d 470, 473 (7th Cir. 1988). Summary judgment is not proper when there is a dispute over facts which might affect the outcome of the suit. *Liberty Lobby*, 477 U.S. at 248. The dispute must be genuine, that is, the party opposing the motion for summary judgment may not "rest on the mere allegations of his pleading, but must set forth specific facts showing there is a genuine issue for trial." *Id.* The nonmovant must also make a showing sufficient to establish any essential element for which it will bear the burden of proof at trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

Plaintiffs bring this action as a shareholder class action. Fed. R. Civ. P. 23(a), (b). In general, the court should make a determination whether the complaint is appropriate for class certification "[a]s soon as practicable after the commencement of [such] an action." Fed. R. Civ. P. 23(c). Whether the case should proceed as a representative action must be determined promptly and "without regard to the virtues of the plaintiffs' legal theory." *Koch v. Standard*, 962 F.2d 605, 607 (7th Cir. 1992).[1] This determina-

[1] District courts must not delay certification on the belief that "the case is doomed on the merits." *Koch v. Standard*, 962 F.2d at 607.

tion should generally be made prior to consideration of motions to dismiss and for summary judgment.

Plaintiffs may maintain this action on behalf of the represented class only if they satisfy the requirements of Fed. R. Civ. P. 23(a) and 23(b). Plaintiffs have the burden of establishing that the requirements of Rule 23 have been met and that the case is appropriate for class-wide adjudication. *Trotter v. Klincar*, 748 F.2d 1177, 1184 (7th Cir. 1984); *Susman v. Lincoln Am. Corp.*, 561 F.2d 86, 90 (7th Cir. 1977). Plaintiffs have not moved for certification of the class and defendants have not made any motion directed to the class allegations. This court is nevertheless obligated to rule on class certification. *See Bieneman v. City of Chicago*, 838 F.2d 962, 963 (7th Cir. 1988). There has been no showing that any of the named plaintiffs would be adequate class representatives. On this record, class certification must be denied. To the extent either party desires a reconsideration on class certification on a more complete record, a motion must be filed within 10 days, under Fed. R. Civ. P. 59(e). *Cf. Koch v. Standard*, 962 F.2d 605, 607 (7th Cir. 1992).

According to the amended complaint, in October 1987, GACC acquired Taft Broadcasting Company ("Taft") for approximately $1.5 billion and changed its name to Great American Broadcasting Company. To finance the acquisition, GACC issued $285 million of 14-3/8% Senior Subordinated Bonds due 1999 and GACC's holding company borrowed $670 million in bank loans and issued 137.5 million of 13-1/4% notes due 1996. In addition, GACC issued 2.7 million shares of its own common stock to Taft shareholders.

In 1989 GACC wished to reduce the outstanding debt from the Taft transaction by issuing new GACC stock in exchange for outstanding bonds and notes. GACC entered

an agreement with Lehman whereby Lehman would purchase and retire $49.4 million of the Taft debt from the Taft debtholders in exchange for Lehman receiving 3.65 million newly issued shares of GACC common stock.

In order to allow Lehman to profit from the transaction, the new shares of GACC had to fetch approximately $12 per share. At the time of the Lehman transaction, GACC was in poor financial condition and GACC could not have sold newly issued stock for $12 per share if it had to file a registration statement and prospectus disclosing the full extent of its financial condition. Thus the need to make the initial stock transaction with Lehman. To ensure Lehman's value in the shares, Lehman would pre-sell the stock before any announcement of the Taft debt repurchase. To encourage Lehman's brokers to recommend the shares to their clients, Lehman's brokers were given a $1 per share commission. Furthermore, Lehman and GACC directed the brokers to use a persuasive script containing false and misleading statements to sell the stock. The brokers were successful and sold all 3.65 million shares to plaintiff Tregenza and others on October 11, 1989.

Using the script to sell the shares, brokers stated that GACC stock was worth twice as much as the current selling price and that within two years the stock should be well into the "$20's," that downside risk at the current price level was less than 10%, and that such prominent names in the investment community as Mario Gabelli and Michael Steinhardt each had holdings in GACC of between 500,000 and 1 million shares implying that these individuals had purchased GACC stock. In fact, plaintiffs allege, the price of GACC stock was grossly inflated at $12 per share, GACC was so laden with debt that GACC stock at any price was extremely risky and highly speculative, and Gabelli and Steinhardt had not purchased their

GACC shares, but rather had received them for their Taft stock in the Taft transaction in 1987. The Lehman brokers also failed to mention that the stock was newly issued, that Lehman was pre-selling the stock to the public at a price that would guarantee Lehman a profit, that GACC's poor cash flow and burdensome long term debt made the stock significantly less valuable than the $12 sales price, that GACC could not have retired the debt through a direct public offering or that Lehman was receiving $1 per share commission, which was higher than the usual and customary commission. Additionally, defendants never disclosed the fact that the shares being pre-sold on October 11, 1989 were obtained on October 12, 1989 by Lehman in exchange for the debt retirement.

Plaintiffs also allege that after the October 11, 1989 sale, Lehman continued to sell GACC stock at inflated prices through December 17, 1991 and that GACC knew and consented to Lehman's sales technique. Lehman brokers allegedly obtained inflated GACC prices during the period by again using a script containing false and misleading statements. Lehman brokers stated that GACC was worth far more than the market price of the stock when, in fact, GACC stock was grossly inflated. In June 1990, Lehman represented that the assets of GACC were worth $14 to $20 per share, at a time when the stock was trading at $5-1/2 to $7-1/2 per share. Lehman brokers stated that Carl Lindner, GACC's largest shareholder, was standing behind GACC and would not allow the price to decline further, when in fact, Lindner could not or would not stop the continuing stock slide. Brokers stated that GACC was selling some assets, including three substantial interests in other corporations, to retire debt and improve profitability when, in fact, the sale of these assets was insufficient to recover profitability. Finally, the brokers represented that GACC's stock prices would rise to a price

comparable[2] to stock prices of other networks such as ABC and CBS when, in fact, GACC's debt made the comparison impossible. Plaintiffs, Haas and Seegers, purchased stock during the period after October 11, 1989.

Defendants argue that plaintiffs' federal securities claims were filed beyond the one-year statute of limitations applicable to plaintiffs' claims. 15 U.S.C. § 77m (Section 12(2)); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2782 (1991) (Section 10(b) and Rule 10b-5); *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385, 1392 (1990), *cert. denied*, 111 S. Ct. 2887 (1991) (Section 10(b) and Rule 10b-5). Defendants argue that the one-year statute of limitations applicable to both the § 10(b) and § 12(2) claims begins to run when plaintiffs discover, or in the exercise of reasonable diligence, should have discovered the alleged violation. Plaintiffs argue that an "inquiry notice" standard is not applicable to the one-year statute of limitations for § 10(b) and Rule 10b-5 claims.

Prior to the *Lampf* decision, the Seventh Circuit applied a one-and-three year statute of limitations borrowed from § 13 of the Securities Act. *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385, 1390 (7th Cir. 1990). In *Lampf*, the Supreme Court ruled that a one-and-three statute of limitations should be applied to such cases, but that the source of that limitation was § 9(e) of the Exchange Act. 111 S. Ct. at 2781. Section 9(e) of the Exchange Act provides that any action must be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation" but includes no express "inquiry notice" language. 15 U.S.C. § 78i(e). By contrast, § 13 of the Securities Act expressly provides

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[2] Comparable in the sense of price over cash flow.

that the one-year period begins after "discovery of the untrue statement or the omission, or after such discovery *should have been made* by the exercise of reasonable diligence." 15 U.S.C. § 77m (emphasis added).[3] Plaintiffs rely on this difference in the express language of the two statutes in arguing that "inquiry notice" no longer applies to the one-year statute of limitations applicable to § 10(b) and Rule 10b-5 claims.

The Supreme Court in *Lampf* did not directly address, nor prescribe how § 9(e)'s one-year limitation was to be applied. 111 S. Ct. at 2782 n. 9. The Court merely stated that "[t]o the extent that [the differences in the statutes] in the future might prove significant, we select [§ 9(e) of the Exchange Act] as the governing standard." *Id.* Courts following *Lampf* are divided over whether the objective standard of "inquiry notice," as opposed to the subjective standard of actual knowledge, continues to apply to § 10(b) cases under § 9(e). Several courts have continued to apply the inquiry notice standard by reading such a requirement into the statute. *See Menowitz v. Brown*, Nos. 1023, 1024, 92-7867, 92-9149, 1993 WL 88691 *4 (2d Cir. March 29, 1993) ("discovery" under Exchange Act limitation 78i(e) "includes constructive or inquiry notice"); *Anixter v. Home-Stake Production Co.*, 947 F.2d 897 (10th Cir. 1991), *vacated on other grounds*, 112 S. Ct. 1658 (1992); *Manning v. Maloney*, 787 F. Supp. 433 (M.D. Pa.), *aff'd*, 980 F.2d 722 (3d Cir. 1992); *Klein v. Goetzmann*, 810 F. Supp. 417 (N.D.N.Y. 1993); *Pomeroy v. Schlegel Corp.*, 780 F. Supp. 980 (W.D.N.Y. 1991); *see also Otto v. Chauncey*, No. 82 C 4762, 1992 WL 447823 *1 (N.D.

[3] Section 77m also provides that "[i]n no event shall any such action be brought . . . more than three years after . . . the sale." 15 U.S.C. § 77m.

Ill. Nov. 15, 1991) (noting that nothing in *Lampf* affected the application of the notice inquiry standard); *Berning v. A.G. Edwards & Sons, Inc.*, 774 F. Supp. 480, 482-83 (N.D. Ill. 1991), *rev'd on other grounds*, No. 91-3218, 1993 WL 84590 (7th Cir. March 25, 1993) (dicta noting *Anixter*); *Rosenberg v. Hano*, 121 F.2d 818, 821 (3d Cir. 1941) (plaintiff filed § 9 claim on representations that stock would go higher, plaintiff's claim was properly a § 13 claim; court noted difficult question implicit in different language of § 9; Prompt and gradual fall of stock should have placed plaintiff on notice under § 13). Several courts, relying on the express language in § 9(e), have determined that "inquiry notice" does not apply to 10(b) and Rule 10b-5 cases after *Lampf*. *See In re Digital Microwave Corp. Securities Litigation*, No. E-90-20241RUW (EAI), 1992 WL 370831 (N.D. Cal. Oct. 19, 1992); *Werner v. Satterlee, Stephens, Burke & Burke*, 797 F. Supp. 1196 (S.D.N.Y. 1992); *Slavin v. Morgan Stanley & Co., Inc.*, 791 F. Supp. 327 (D. Mass. 1992); *Hauman v. Illinois Power Co.*, No. 89-1130, 1991 WL 354887 (C.D. Ill. Aug. 29, 1991) (decided prior to *Anixter*).[4]

In selecting § 9(e), the Supreme Court "did not necessarily indicate a preference for the type of notice of the violation but sought a 'governing' standard to link the implied § 10(b) remedy to those express securities causes of action which uniformly require [claims be brought] one year after notice of the violation and not more than three years after the violation." *Anixter*, 947 F.2d at 899. The

[4] As an initial matter, it should be noted that the Seventh Circuit, which itself applied the inquiry notice doctrine prior to *Lampf*, requires district courts to follow, in the absence of Seventh Circuit authority, the consistent decisions of other Circuit Courts. *See Colby v. J.C. Penney Co., Inc.*, 811 F.2d 1119, 1123 (7th Cir. 1987).

Seventh Circuit's discussion of this limitation in *Short v. Belleville Shoe*, 908 F.2d at 1385, which applied the inquiry notice standard, was cited in *Lampf* with approval. *Anixter*, 947 F.2d at 899 n. 4.

In *Lampf*, the Supreme Court rejected application of the equitable tolling doctrine because the doctrine is "fundamentally inconsistent with the 1-and-3-year structure" of § 9(e). 111 S. Ct. 2782. The *Hauman* court (prior to *Anixter*) found this holding relevant to the interpretation of "discovery" under § 9(e) and rejected inquiry notice. 1991 WL 354887 at *1. The *Hauman* court pointed to the Supreme Court's statement that "[t]he 1-year period, *by its terms, begins after discovery of the facts constituting the violation*, making tolling unnecessary. The 3-year limit is a period of repose inconsistent with tolling." *Id.* (emphasis added). Therefore, the *Hauman* court reasoned, under § 9(e), the one-year limit is essentially "tolled" to a maximum of three years, however, the one-year limit follows a subjective knowledge standard.

Lampf's rejection of equitable tolling does not have such broad implications. In rejecting equitable tolling, the Supreme Court was only ensuring the effectiveness of the statute's three-year repose. *Id.* ("The 3-year limit is a period of repose inconsistent with tolling.") With respect to the one-year limit, equitable tolling is equally "unnecessary" to either a subjective discovery or an objective discovery-inquiry notice limitation. Equitable tolling tolls the statute where the party remains in ignorance of the fraud "without any fault or want of diligence or care on his part." *Id.* A party cannot both have inquiry notice and merit equitable tolling. The Supreme Court did not specifically overrule the application of an "inquiry notice" standard in *Lampf*. Therefore, following the interpretations of the Second and Tenth Circuits, the inquiry notice

standard applied by the Seventh Circuit in *Belleville Shoe* continues to apply to the one-year statute of limitations in § 10(b) and Rule 10b-5 cases.[5]

Under inquiry notice, the statute of limitations does "not await [plaintiffs'] leisurely discovery of the full details of the alleged scheme." *Hupp v. Gray*, 500 F.2d 993, 996 (7th Cir. 1974); *DeBruyne v. Equitable Life Assur. Soc. of the U.S.*, 920 F.2d 457, 466 (7th Cir. 1990); *Astor Chauffeured Limousine Co. v. Runnfeldt Investment Corp.*, 910 F.2d 1540, 1544 (7th Cir. 1990). Plaintiffs must file within one year of discovery of the facts constituting the fraud or within one year after discovery should have been made through reasonable diligence. *DeBruyne*, 920 F.2d at 466. While an objective reasonable diligence standard "does not lend itself easily to summary judgment, neither is such a motion always doomed to failure." *Id.*

Defendants argue that the dramatic decline in GACC stock price from $12 per share in October 1989 to approximately $2 per share by October 1990, in direct contradiction of the alleged misrepresentations received in the fall of 1989, put plaintiffs in a position of inquiry and actual notice. Defendants argue that the drop in stock price should have aroused suspicion regarding the alleged misrepresentations as to both the October 11, 1989 transaction with Tregenza and the subsequent transactions by Haas and Seegers. Defendants cite *Hupp v. Gray*, 500

[5] There are at least three drawbacks to an actual knowledge standard. First, plaintiffs are discouraged from taking actions to bring the fraud to light. Second, defendants lose the security of repose. And third, defendants are prejudiced in their ability to meet plaintiffs' allegations. *Brumbaugh v. Princeton Partners*, 985 F.2d 157, 162 (4th Cir. 1993). An actual knowledge standard, as this case demonstrates, would have the effect of eviscerating the one-year limitation and creating a *de facto* three-year limitation.

F.2d 993, 996-97 (7th Cir. 1974) in support. In *Hupp*, plaintiff's § 10(b) claims were barred by the statute of limitations and plaintiff urged equitable tolling. 500 F.2d at 996. Affirming dismissal of plaintiff's claims, the Seventh Circuit determined that equitable tolling was unavailable because plaintiff had not used reasonable diligence in investigating potential claims. At the time of the sale, the defendant-broker had told the plaintiff that the stock might go much higher because the company was about to receive an important contract. In direct contradiction of the broker's representations, the stock price plummeted from the purchase price of $47 per share in January 1966 down to $17-1/2 per share by March 1967. In affirming dismissal of plaintiff's complaint, the *Hupp* court stated:

> Even a wholly unsophisticated investor should have realized in March 1967 . . . the existence of facts sufficient to precipitate [suspicion]. The sharp fall in the market price was not a concealed fact but, rather, was clearly and painfully revealed to the plaintiff. "At the very least, [the stock drop] should have aroused suspicion or curiosity on the part of plaintiff." . . . [Plaintiff] could easily have inquired [of another broker] what had happened to [the Company.]

Id. at 996-97.

Plaintiffs are put on inquiry notice when there are "storm warnings" that would alert a reasonable investigator to the possibility of fraudulent statements or omissions in his securities transaction. *DeBruyne*, 920 F.2d at 467; *see also Astor Chauffeured Limousine*, 910 F.2d at 1544. In *DeBruyne*, the court held that "storm warnings" existed when plaintiffs admitted that they had received a letter which made them "suspicious" over one year prior to filing the complaint. 920 F.2d at 466; *see also Davidson v. Wilson*, 973 F.2d 1391 (8th Cir. 1992) (storm warnings put plaintiff on inquiry notice where form K-1 reflecting fallacy

of representations was received over one year before suit). Plaintiffs argue that these cases are distinguishable in that they involved plaintiffs who were in receipt of documented information but simply failed to read it. In this case, plaintiffs argue they lacked "access to information that would give plaintiffs knowledge of the fraud."[6]

Plaintiffs' most concise argument is that because the Lehman brokers made multiple misrepresentations regarding the value of the stock, the value of GACC's assets and the persons standing behind GACC stock, that the market decline was not sufficient to put them on inquiry notice. *See Jolly v. Pittore*, Fed. Sec. L. Rep. (CCH) ¶ 96,943 (S.D.N.Y. 1992) (genuine issue of material fact regarding inquiry notice where letter sent more than one year prior to filing blamed partnership problems on the economy); *see also Robertson v. Deloitte, Haskins & Sells*, 732 F. Supp. 979 (E.D. Ark. 1990) (receipt of bankruptcy petition did not create inquiry notice that offering memorandum fraudulently represented condition of general partner). Defendants, however, point to numerous cases indicating that a stock slide like the one in this case amounts to a "storm warning" sufficient to put plaintiffs on inquiry notice. *See Buder v. Merrill Lynch Pierce, Fenner & Smith*, 644 F.2d 690, 692 (8th Cir. 1981) (investor received reports on investments showing poor performance, putting him on inquiry notice of possible misrepresentation of soundness and risk of investment by broker); *Koke v. Stifel, Nicolaus & Co., Inc.*, 620 F.2d 1340, 1342-45 (8th

[6] Plaintiffs also make a "futility" argument, that had they asked about the stock price, they would have been told the same reassuring statements they were told when they purchased the lower price shares. However, inquiring of the same broker suspected of having misrepresented information seems neither prudent nor diligent.

Cir. 1980) (unread confirmation slips indicated bond values were declining and being sold at a loss despite broker's assertion of safety); *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 682 (9th Cir. 1980) (broker failed to explain highly speculative nature of securities; plaintiff knew that stocks were declining precipitously; inaccuracy of broker's prediction that company stock would split and increase dividend was demonstrated by fact that events never occurred; plaintiff on inquiry notice); *Gaudin v. KDI Corp.*, 576 F.2d 708, 712 (6th Cir. 1978) (fact that none of glowing promises occurred and that stock dropped, should have placed plaintiffs on notice); *Hecox v. R.G. Dickerson & Co.*, No. 84-1789, 1987 U.S. Dist. LEXIS 13901, at 13 (D. Kan. Jan. 12, 1987) (statute begins to run when investor learns that reportedly low risk/high potential investment is performing directly contrary to those representations); *Murray v. Shearson Heyden Stone, Ltd.*, 524 F. Supp. 304, 305-6 (N.D. Ga. 1980); *Bresson v. Thomson McKinnon Securities, Inc.*, 641 F. Supp. 338, 345 (S.D.N.Y. 1986); *see also Majeski v. Balcor Entertainment Co. Ltd.*, 786 F. Supp. 1458, 1466 (E.D. Wis. 1992) (plaintiffs put on notice where warnings contained in prospectus).

In this case, plaintiffs claim the following representations by Lehman brokers on October 11, 1989: that the stock was worth twice as much as the selling price and would be selling well into the $20's, that downside risk was limited to 10% and that prominent persons in the investment community were holding large amounts of the stock. Beginning in November, 1989, the Lehman brokers are alleged to have represented that: GACC was worth far more than the market price of its stock when, in fact, GACC stock was grossly inflated; that the assets of GACC were worth $14 to $20 per share, at a time when the stock was trading at $5-1/2 to $7-1/2 per share; that

Carl Lindner, GACC's largest shareholder, was standing behind GACC and would not allow the price to decline further, when in fact, Lindner could not or would not stop the continuing stock slide; that GACC was selling some assets, including three substantial interests in other corporations, to retire debt and improve profitability when, in fact, the sale of these assets was insufficient to recover profitability; and that GACC's stock prices would rise to a price comparable to stock prices of other networks when, in fact, GACC's debt made such a comparison impossible.

The fallacy of all of these representations became very clear at most one year after October 11, 1989. By October 1990, GACC stock had ended a steady and consistent slide and was trading in the $1 and $2 range, down from its price one year earlier of approximately $12.[7] Nonetheless, plaintiffs continued to purchase GACC stock and, therefore, were very aware of the stock slide. Plaintiffs' complaint characterizes GACC's stock slide as a slow decline from approximately $12 per share in October, 1989 to approximately $1 per share by December, 1991. In reality, GACC stock hit the low one and two dollar mark by October 1990, much more than a year before plaintiffs filed their complaint. Although the sale of Hanna Barbera, which Lehman brokers alleged in June 1990 would provide $350-400 million, but ultimately only produced $255 million, was not completed until December 1991, this fact alone did not prevent plaintiffs from being placed on notice by the stock slide. Plaintiffs do not rely on the Hanna Barbera sale to justify their delay in filing.[8] Plain-

[7] Based on defendants' uncontroverted stock price information.

[8] In fact, the amended complaint does not plead any facts indicating exactly when plaintiffs discovered the violations.

tiffs were on notice of the possible fallacy of Lehman's predictions regarding the effect of the Hanna Barbera sale much earlier than December 1991, as the sale was not accomplished until nearly two years after the statements were allegedly made.

Plaintiffs' complaint was filed September 21, 1992, one month within the three-year limit from plaintiff, Tregenza's initial purchase on October 11, 1989, and almost that long after Haas' and Seegers' first transactions in November, 1989. Haas and Seegers argue in their response brief that they did not become aware of an alleged fraud until an article that appeared in the February, 1992 issue of *Equities* magazine called the relationship between Lehman and GACC into question.[9] Similarly, plaintiff Tregenza argues in the response brief that he first became aware of the possible violations when his broker, Tim Hayes, passed on a rumor in March, 1992. *See* Tregenza affid. ¶ 9.

Having accepted as true plaintiffs' allegations regarding defendants' misrepresentations and omissions, there is no genuine issue of material fact as to the enormous stock slide which occurred throughout 1990. As a matter of law,

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[9] The affidavits of plaintiffs Haas and Seegers state that the February, 1992 *Equities* article "suggested that Lehman and GACC first artificially inflated the price of GACC [stock] to sell a block of unregistered stock in October, 1989" and "thereafter, Lehman, GACC and prominent 'short' sellers conspired to artificially depress the price of the stock, perhaps for the purpose of allowing GACC to buy back its debentures at artificially low prices." As defendants note, the rationale propounded for defendants' attempt to depress the stock price does not make immediate sense. Nonetheless, it is the allegation that defendants artificially depressed the stock, regardless of the reason, which is relevant to the inquiry on summary judgment. Furthermore, the *Equities* article does not refer to the initial pre-selling agreement and does not indicate that GACC was involved in Lehman's alleged scheme.

plaintiffs were on inquiry notice and should have discovered the facts constituting the violation more than one year prior to the filing of their complaint. Therefore, plaintiffs' § 10(b) and Rule 10b-5 claims will be dismissed as time-barred.

The same inquiry notice standard, and a one-and-three year limitation, also applies to plaintiffs' § 12(2) Securities Act claims. 15 U.S.C. § 77m. Therefore, the statute of limitations applicable to either plaintiffs' § 10(b) or § 12(2) claims begins to run at the same time. Plaintiffs' § 12(2) claims are also time-barred and will be dismissed.

Not only are plaintiffs required to file within the relevant statute of limitations, but they are also required to affirmatively plead facts showing compliance with the one-year statute of limitations applicable to their claims. *Davidson v. Wilson*, 973 F.2d 1391, 1402 n. 8 (8th Cir. 1992) (dismissing plaintiff's § 12(2) claim for failure to affirmatively allege compliance with statute of limitations); *In re VMS Securities Litigation*, 752 F. Supp. 1373, 1389 (N.D. Ill. 1990) (dismissing § 12(2) and § 10(b) claims and noting failure to affirmatively plead compliance with statute of limitations); *Caliber Partners, Ltd. v. Affeld*, 583 F. Supp. 1308, 1312 (N.D. Ill. 1984) (citing *Adair v. Hunt Int'l Resources Corp.*, 526 F. Supp. 736, 748-49 (N.D. Ill. 1981)) (§ 12(2) claim dismissed for failure to affirmatively allege limitations compliance); *In re Chaus Securities Litigation*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,987 at 94,282, 94,286 (S.D.N.Y. Sept. 1, 1992). With the exception of ¶ 43[10] of the amended complaint, plaintiffs fail to

[10] Paragraph 43 of the amended complaint alleges "[p]laintiffs and members of the class did not know of the untruths and omissions alleged above." The *Caliber* court dismissed an almost identical § 12(2) complaint. 583 F. Supp. at 1312 & n. 8.

affirmatively allege when and how each plaintiff discovered the untrue statements, the reasons the untruth of the statements was not discovered earlier than one year after they were made, and the efforts made to discover the untruths. *See Chaus*, at 94,282. This failure to plead compliance with the applicable limitations period also justifies dismissal of plaintiffs' federal securities claims.

Additionally, defendants argue that § 12(2) does not apply to after market purchases and that, therefore, the § 12(2) claims of at least Haas and Seegers should be dismissed. Although plaintiff notes the split of authority on this issue and cites various cases including after market transactions within § 12(2), *see e.g., Farley v. Bair, Patrick & Co.*, 1991 Fed. Sec. L. Rep. (CCH) ¶ 95,658 (S.D.N.Y. 1991); *Elysian Federal Sav. Bank v. First Interregional Equity Corp.*, 713 F. Supp. 737, 749 (D.N.J. 1989); *Ramtek Sec. Litigation*, 1990 Fed. Sec. L. Rep. (CCH) ¶ 95,483 at 97,521 (N.D. Cal. 1990); *Scotch v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 709 F. Supp. 95, 98 (M.D. Pa. 1988); *Wilko v. Swan*, 127 F. Supp. 55, 58 (S.D.N.Y.), *aff'd on other grounds*, 346 U.S. 427 (1953), the Third Circuit authority and other cases in this district holding that § 12(2) does not apply to after market purchases are both more numerous and more persuasive, *see Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682 (3d Cir.), *cert. denied*, 112 S. Ct. 79 (1991); *Fujisawa Pharmaceutical Co. v. Kapoor*, No. 92 C 5508, 1993 WL 45147 (N.D. Ill. Feb. 10, 1993) (compiling cases, noting vast majority of cases generally hold § 12(2) only applies to initial offerings); *Pacific Dunlop Holdings, Inc. v. Allen & Co., Inc.*, 90 C 5678, 1991 WL 348493 (N.D. Ill. May 15, 1991) (app. pending). *Fujisawa* represented a case factually very similar to this case. In that case, two entities essentially owned all the public stock of a corporation and sold it.

In *Fujisawa*, defendants argued that plaintiffs failed to state a § 12(2) claim because the stock was not sold in an initial offering. The court, noting a possible exception to this general rule where a majority insider sold stock, declined to hold that plaintiffs had failed to state a § 12(2) claim. In so ruling, however, the *Fujisawa* court reviewed the large volume of cases involving application of § 12(2) to after market transactions stating: "[T]he great weight of authority" seems to support the position that § 12(2) does not apply to after market transactions. *Fujisawa*, 1993 WL 45147; *see Ballay*, 925 F.2d at 687-91 (express language and intent of Congress leads to finding that 12(2) applies only to initial offerings); *Pacific Dunlop Holdings, Inc. v. Allen & Co.*, No. 90 C 5678, 1991 WL 348493 (N.D. Ill. May 16, 1991) (adopting the holding of *Ballay*).

The Third Circuit's decision in *Ballay* that § 12(2) does not apply to after market transactions was based on the language of Section 12(2), its legislative history, the structure and purpose of the Securities Act, including the specific intent to regulate initial offerings, and policy considerations. Plaintiffs argue, with some cited support, *see* 9 L. Loss & J. Seligman, *Securities Regulation* (3d ed.) 1417 (1992), that *Ballay* was based on the mistaken belief that the Securities Act applies exclusively to new stock issues. Supporting this argument, plaintiffs note that § 17(a) of the Securities Act is not limited to initial offerings. Plaintiffs apparently ignore *Ballay*'s analysis of legislative history indicating that § 17 was intended to have broader application than § 12(2). 925 F.2d at 691-92. Since the Third Circuit and the great majority of district courts examining this issue have determined that § 12(2) does not apply to after market transactions, those claims of plaintiffs, Haas and Seegers, will also be dismissed for failure to state a claim.

Plaintiffs' state claims are brought under supplemental jurisdiction. 28 U.S.C. § 1367. Because plaintiffs' federal claims will be dismissed before trial, this court declines to exercise jurisdiction over those supplemental state claims. *Martin-Trigona v. Champion Federal Sav. & Loan Ass'n*, 892 F.2d 575, 578 (7th Cir. 1989); *Midwest Grinding, Inc. v. Spitz*, 769 F. Supp. 1457, 1470 (N.D. Ill. 1991). They will be dismissed without prejudice.

IT IS THEREFORE ORDERED that the motions of defendants, Great American Communications Company and Shearson Lehman Brothers, Inc., to dismiss the amended complaint of plaintiffs, Tregenza, Haas and Seegers [27, 28] are granted. Class certification is denied. The Clerk of the Court is directed to enter judgment in favor of defendants and against plaintiffs, dismissing plaintiffs' federal claims stated in Counts I and II. Plaintiffs' individual state claims in Counts III and IV and class allegations are dismissed without prejudice.

ENTER:

/s/ WILLIAM T. HART
United States District Judge

Dated: APRIL 30, 1993

Supreme Court, U.S.
FILED
APR 22 1994
OFFICE OF THE CLERK

No. 93-1524

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

W. KENNETH TREGENZA, JAMES E. HAAS, and ERWIN B. SEEGERS, on behalf of themselves and a class of persons similiarly situated,

Petitioners,

v.

GREAT AMERICAN COMMUNICATIONS COMPANY, a Florida corporation, and SHEARSON LEHMAN BROTHERS, INC., a Delaware corporation,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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20 pp

QUESTION PRESENTED

Whether the Seventh Circuit correctly found that courts may apply the doctrine of inquiry notice to the one year limitations period contained in Section 9(e) of the Securities Exchange Act of 1934?

LIST OF PARTIES

Petitioners-Plaintiffs:

Kenneth Tregenza

James E. Haas

Erwin B. Seegers

Respondents-Defendants:

Great American Communications Company

Lehman Brothers Inc. (Lehman Brothers Inc. is the successor corporation to the corporation that was formerly known as Shearson Lehman Brothers Inc.).

The following is furnished in compliance with Supreme Court Rule 29.1:

Lehman Brothers Inc.

Parent Company—The American Express Company
Subsidiaries (except wholly owned)—None

Great American Communications Company

Parent Company—None
Subsidiaries (except wholly owned)—None

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
LIST OF PARTIES	ii
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
STATUTES INVOLVED	1
STATEMENT OF THE CASE	1
REASONS WHY THE PETITION SHOULD BE DENIED	5
I. Summary Of The Argument	5
II. The Seventh Circuit's Decision Does Not Conflict With This Court's Decision in *Lampf*	6
III. No Genuine Conflict Exists Among The Circuit Courts Of Appeal	8
CONCLUSION	11
APPENDIX	*infra*

TABLE OF AUTHORITIES

Cases:	PAGE
Anixter v. Home-Stake Production Co., 977 F.2d 1549 (10th Cir. 1992), *cert. denied sub nom. Thorner v. Cross*, 113 S. Ct. 1842 (1993) ...	5-6 & n.2
Anixter v. Home-Stake Production Co., 947 F.2d 897 (10th Cir. 1991), *vacated on other grounds sub nom. Dennler v. Trippet*, 112 S. Ct. 1658, 118 L. Ed. 2d 382 (1992)	7-8
Ceres Partners v. GEL Associates, 918 F.2d 349 (2d Cir. 1990)	10
In re Data Access Systems Securities Litigation, 843 F.2d 1537 (3d Cir.), *cert. denied sub nom. Vitiello v. Kahlowsky & Co.*, 488 U.S. 849, 109 S. Ct. 131, 102 L. Ed. 2d 103 (1988)	6 n.2, 9
Dodds v. Cigna Securities, Inc., 12 F.3d 346 (2d Cir. 1993), *cert. denied*, 62 U.S.L.W. 3657 (U.S., Apr. 4, 1994)	5, 6 n.2, 8
Goldenberg v. Bache & Co., 270 F.2d 675 (5th Cir. 1959)	8
Gruber v. Price Waterhouse, 911 F.2d 960 (3d Cir. 1990)	6 n.2, 9
Howard v. Haddad, 962 F.2d 328 (4th Cir. 1992) ..	8
Kress v. Hall-Houston Oil Co., RICO Bus. Disp. Guide (CCH) ¶ 8348, 1993 WL 166274 (D.N.J. May 12, 1993)	11
Lampf, Pleva, Lipkind, Prubis & Petigrow v. Gilbertson, 111 S. Ct. 2773, 115 L. Ed. 2d 321 (1991)	6-10
Manning v. Maloney, 787 F. Supp. 433 (M.D. Pa.), *aff'd*, 980 F.2d 722 (3d Cir. 1992)	10
Menowitz v. Brown, 991 F.2d 36 (2d Cir. 1993) ..	8, 10

Norris v. Wirtz, 818 F.2d 1329 (7th Cir.), *cert. denied*, 484 U.S. 943, 108 S. Ct. 329, 98 L. Ed. 2d 356 (1987) 11

Rolo v. City Investing Co. Liquidating Trust, 1994 WL 14474 (D.N.J. Jan. 19, 1994) 10-11

Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887, 115 L. Ed. 2d 1052 (1991) 10

Westinghouse Elec. Corp. By Levit v. Franklin, 993 F.2d 349 (3d Cir. 1993) 9-10

Statutes:

15 U.S.C. § 77l 1

15 U.S.C. § 77m 4

15 U.S.C. § 78i(e) ..... *passim*

15 U.S.C. § 78j ..... *passim*

15 U.S.C. § 78n(a) 9

15 U.S.C. § 78cc(b) 8

Ill. Rev. Stat., ch. 121½, §§ 137.1 *et seq.* 1

Regulations:

17 C.F.R. § 240.10b-5 ..... *passim*

No. 93-1524

IN THE

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OCTOBER TERM, 1993

W. KENNETH TREGENZA, JAMES E. HAAS, and ERWIN B. SEEGERS, on behalf of themselves and a class of persons similiarly situated,

Petitioners,

v.

GREAT AMERICAN COMMUNICATIONS COMPANY, a Florida corporation, and SHEARSON LEHMAN BROTHERS, INC., a Delaware corporation,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

OPINIONS BELOW

The opinion of the Seventh Circuit is reported at 12 F.3d 717 (7th Cir. 1993) and is reproduced in Petitioners' Appendix ("App.") at pages 1-10. The Judgment of the Seventh Circuit is reproduced at App. 11. The opinion of the District Court is reported at [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,745 (N.D. Ill., Apr. 30, 1993) and is reproduced at App. 12-31.

STATUTES INVOLVED

The statutory provisions involved are §§ 9(e) and 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78i(e) and 78j(b). Pursuant to Supreme Court Rule 24(f), these statutes are set forth in the Appendix hereto.

STATEMENT OF THE CASE

This action was filed by Petitioner W. Kenneth Tregenza ("Tregenza") on September 21, 1992 as a purported class action on behalf of persons who purchased common stock of Great American Communications Company ("GACC") during the time period from October 11, 1989 to December 17, 1991. On November 3, 1992, an Amended Complaint was filed which also added Petitioners James E. Haas ("Haas") and Erwin B. Seegers ("Seegers"). Both GACC and Shearson Lehman Brothers Inc. ("Lehman") were named as defendants. The Amended Complaint alleged claims under § 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1990), promulgated thereunder, § 12(2) of Securities Act of 1933 (the "1933 Act"), the Illinois Securities Law of 1953, Ill. Rev. Stat., ch. 121-1/2, §§ 137.1 *et seq.*, and common law negligent misrepresentation.

The gravamen of the Amended Complaint is that Respondents conspired to sell GACC common stock to the public through a series of misrepresentations designed to artificially inflate the price of the stock. Petitioners claimed that on October 11, 1989, Lehman sold GACC common stock to Tregenza and others at a price of $12.50 per share based upon alleged misrepresentations by Lehman that the "stock was worth twice as much as the current selling price," would trade well into the $20's within two years, and that the downside risk at $12.50 a share was less than 10%, *i.e.*, the stock would not drop below $11.25 per share. Tregenza also claimed that the shares he purchased were among the 3.65 million "newly issued shares" of GACC sold on October 11, 1989, and alleged a separate claim under the Illinois Securities Act asserting that his shares purchased on that date were not properly registered.[1]

Petitioners also claimed that after October 11, 1989 and continuing up to and including December 17, 1991, Lehman sold GACC common stock to Petitioners Haas and Seegers, as well as to others, at prices as high as $10.875 per share, through alleged misrepresentations by Lehman that the stock price would rise and trade well into the $20's within

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[1] Specifically, the Amended Complaint alleged that GACC negotiated an agreement with Lehman whereby Lehman: (i) purchased various amounts of debt from private debtholders; and (ii) exchanged that debt with GACC for 3.65 million shares of "newly issued" GACC common stock on October 12, 1989. Lehman is alleged to have sold those "newly issued" shares to the public on October 11, 1989 in violation of the Illinois Securities Act. Tregenza alleged a separate claim under the Illinois Act in Count III of the Amended Complaint regarding his purchase on that date. This state law claim was dismissed, without prejudice, upon the dismissal of the federal claims. Both GACC and Lehman have denied any wrongful conduct with respect to this transaction which was publicly announced on October 12, 1989.

two years, GACC was worth far more than the stock price indicated, the stock only had a 10% downside risk and GACC's largest shareholder would not allow the stock price to decline any further. Haas alleged that between November 15, 1989 and November 2, 1991 he purchased a total of 117,500 shares of GACC in the open market at prices ranging from $10.75 to $1.22 per share. Seegers alleged that between November 10, 1989 and June 10, 1991 he purchased a total of 50,000 shares in the open market at prices ranging from $10.875 to $2 per share. All of these purchases by Haas and Seegers were made at continually declining prices. None of the Petitioners contends that anyone from GACC met with or spoke to them concerning their purchases of GACC stock.

The Seventh Circuit affirmed the District Court's finding that the undisputed facts demonstrated that Petitioners were fully aware by no later than October 1990 that the price of GACC stock had performed directly contrary to the representations upon which Petitioners allegedly relied in making their purchases. As the Seventh Circuit found, "[i]mmediately after the sale of the stock on October 12, 1989, its market price began [an] exorable [decline]. By October 1990, the price had fallen to $1.50. Later it fell below $1. It has never come back up." 12 F.3d at 720. The fall to $1.50 represented an 88% decline from Tregenza's purchase price and an 86% decline from Haas' and Seegers' initial purchase prices. Both the Seventh Circuit and the District Court found that this price decline by October 1990 was directly contrary to the representations allegedly made at the time of purchase that the stock's downside risk was no more than 10% and that the stock would trade well into the $20's within two years. As the Seventh Circuit concluded, "an investor would have become suspicious and investigated when Lehman's emphatic and precise prediction

was so swiftly and dramatically falsified." 12 F.3d at 720 (citations omitted).

Thus, the Seventh Circuit, in an opinion written by Chief Judge Posner, affirmed the District Court's finding that Petitioners were placed on inquiry notice of their claims by no later than October 1990—almost two years before this action was filed in September, 1992. *Id.* Furthermore, the Seventh Circuit found nothing to suggest that Congress intended to prevent courts from applying the traditional doctrine of inquiry notice to § 9(e)'s one-year limitations period. *Id.* at 721-22. The Seventh Circuit stated:

> The precise question, then, is not: Does section 9(e) incorporate the rule of inquiry notice? It is: are courts free to apply to the section the judge-made doctrine of inquiry notice, long applied in fraud cases outside as well as inside the securities field? [citations omitted]. Nothing in the language, history or purpose of section 9(e) forecloses so modest and traditional an exercise of judicial creativity. It is traditional in securities law as well as in other fields.

Id. at 722.

The Seventh Circuit found that the utility of inquiry notice was not diminished by § 9(e)'s three-year period of repose:

> The utility of inquiry notice and hence the propriety of our interpretation may seem diminished by the presence of a three-year statute of repose. Not so—for section 13 of the 1933 Act has the same three-year statute of repose yet Congress wrote inquiry notice into the one-year statute of limitations in that section.

Id.

Moreover, the court observed that its interpretation of the statute was fully supported by policy considerations:

> Three years is an age in the stock market. If the suspicious investor had a wide choice of times at which to sue within a three-year period rather than being required to sue no more than one year after the earliest possible date, the opportunistic use of the federal securities laws to protect investors against market risk would be magnified. These plaintiffs waited patiently to sue. If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages. Heads I win, tails you lose. This tactic is discouraged by the doctrine of inquiry notice, which we hold is applicable in Rule 10b-5 suits.

Id.

REASONS WHY THE PETITION SHOULD BE DENIED

I.

SUMMARY OF THE ARGUMENT

The decision of the Seventh Circuit in this case is fully consistent with decisions of this Court and other Courts of Appeal. In fact, there is no genuine conflict between the decision of the Seventh Circuit in this case and the decisions of any other Circuit Court.

Indeed, this Court has twice denied review of the same issue presented by Petitioners here. *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346 (2d Cir. 1993), *cert. denied*, 62 U.S.L.W. 3657 (U.S., Apr. 4, 1994); *Anixter v. Home-Stake Production Co.*, 977 F.2d 1549 (10th Cir. 1992), *cert. denied sub nom. Thorner v. Cross*, 113 S. Ct. 1842 (1993) (denying

a Cross-Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit seeking review of the same issue).[2] The same result should follow here.

II.

THE SEVENTH CIRCUIT'S DECISION DOES NOT CONFLICT WITH THIS COURT'S DECISION IN *LAMPF*

In *Lampf*, this Court did not decide the issue that was resolved in *Tregenza*, *i.e.*, whether courts may apply the judicial doctrine of inquiry notice to the one year limitations period contained in § 9(e). Therefore, there is no conflict between *Tregenza* and this Court's decision in *Lampf*.

This Court ruled in *Lampf* that private causes of action under § 10(b) and Rule 10b-5 are governed by § 9(e) which provides a limitations period of one year "after discovery of the facts constituting the violation", but not more than three years after the violation. 111 S. Ct. at 2782. The Court's majority opinion in *Lampf* chose § 9(e) as the governing statute, but never addressed whether discovery under the one-year period contained in that statute runs from the

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[2] The issues presented by the Petition for a Writ of Certiorari in *Dodds* are reported at 62 U.S.L.W. 3649 (U.S. Mar. 29, 1994). The issues presented by the Cross-Petition for a Writ of Certiorari in *Thorner* are reported at 61 U.S.L.W. 3690 (U.S. Apr. 6, 1993). The Petitioners in *Dodds* and the Cross-Petitioners in *Thorner* made the same arguments based on *Lampf, Pleva, Lipkind, Prubis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 115 L. Ed. 2d 321 (1991), *In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.), *cert. denied sub nom. Vitiello v. Kahlowsky & Co.*, 488 U.S. 849, 109 S. Ct. 131, 102 L. Ed. 2d 103 (1988), and *Gruber v. Price Waterhouse*, 911 F.2d 960 (3d Cir. 1990), as Petitioners do here. *See Dodds* Petition for a Writ of Certiorari (No. 93-1419, filed Mar. 10, 1994); *Thorner* Cross-Petition for a Writ of Certiorari (No. 92-1294, filed Jan. 25, 1993).

date of inquiry notice as opposed to from the date of actual knowledge.

However, Justice Kennedy filed a dissenting opinion in *Lampf*, agreeing with the majority opinion that "a limitations period [of] 1-year-from-discovery rule" was appropriate, 111 S. Ct. 2788, which he described as running from the time "an investor discovered *or should have discovered* a violation." *Id.* at 2790 (emphasis supplied). The Court expressly commented on this dissenting opinion and did not disagree with Justice Kennedy's conclusion that the one-year period runs from inquiry, as well as actual, notice: "Justice KENNEDY would borrow the one-year limitations period contained in the 1934 Act but not the accompanying period of repose." *Id.* at 2782 n. 8.

Similarly, the Tenth Circuit concluded that *Lampf* did not decide that the one year limitations period of § 9(e) runs only from actual knowledge of a violation:

> When the Court selected §9(e), it did not necessarily indicate a preference for the type of notice of the violation but sought a "governing" standard to link the implied §10(b) remedy to those express securities causes of action which uniformly require one year after notice of the violation and not more than three years after the violation.

Anixter v. Home-Stake Production Co., 947 F.2d 897, 899 (10th Cir. 1991), *vacated on other grounds sub nom. Dennler v. Trippet*, 112 S. Ct. 1658, 118 L. Ed. 2d 382 (1992) (footnote omitted).

Accordingly, since the issue resolved in *Tregenza* was not addressed in *Lampf*, there is no conflict between the two opinions.

III.

NO GENUINE CONFLICT EXISTS AMONG THE CIRCUIT COURTS OF APPEAL

Petitioners also argue that *Tregenza* conflicts with decisions of the Third Circuit. That is not correct. The Third Circuit has not held that courts may not apply the judicial doctrine of inquiry notice to the one year limitations period contained in § 9(e).

As Petitioners concede, the Second and Tenth Circuits agree with the Seventh Circuit that inquiry notice triggers the running of the one year limitations period of § 9(e). *See Dodds*, 12 F.3d at 353 (2d Cir. 1993); *Menowitz v. Brown*, 991 F.2d 36, 41 (2d Cir. 1993); *Anixter*, 947 F.2d 897 (10th Cir. 1991).

The Fourth Circuit concurs. In *Howard v. Haddad*, 962 F.2d 328 (4th Cir. 1992), the Fourth Circuit stated that the applicable inquiry under *Lampf* is whether the plaintiff commenced his § 10(b) action "within one year after the discovery of the facts constituting the violation" which meant that the "one year discovery limitations period thus began running either when [plaintiff] had notice of these facts or when, exercising reasonable diligence, he would have discovered them." *Id.* at 330 (citation omitted).

The Fifth Circuit, as noted in *Tregenza*, has placed the same inquiry notice interpretation on Section 29(b) of the 1934 Act, which, similar to § 9(e), requires that an action be brought "within one year after the discovery that such sale or purchase involves such violation." 15 U.S.C. § 78cc(b); *Goldenberg v. Bache & Co.*, 270 F.2d 675, 681 (5th Cir. 1959) ("discovery" pursuant to § 29(b) "means either actual knowledge or notice of facts which, in the exercise of due diligence, would have led to actual knowledge of the violation." (footnote omitted)).

The decisions of the Third Circuit cited by Petitioners are not to the contrary. *In re Data Access*, 843 F.2d 1537 (3d Cir.), *cert. denied sub nom. Vitiello v. Kahlowsky & Co.*, 488 U.S. 849, 109 S. Ct. 131, 102 L. Ed. 2d 103 (1988), *Gruber*, 911 F.2d 960 (3d Cir. 1990), and *Westinghouse Elec. Corp. By Levit v. Franklin*, 993 F.2d 349 (3d Cir. 1993), either do not address the issue of what notice is required to commence the one year limitations period of § 9(e), or discuss the issue solely in dicta.

Data Access, decided before *Lampf*, does not discuss the issue of whether "discovery" under § 9(e) includes inquiry as well as actual notice. The court simply recited the language of the statute—that claims under § 10(b) and Rule 10b-5 are governed by a limitations period of "one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation." 843 F.2d at 1550.

In *Gruber*, the Third Circuit expressly declined to reach the issue, noting only in a footnote in dicta that while a district court's adoption of an inquiry notice standard to a § 10(b) claim "may" have been error, it was "harmless error" and the issue was "irrelevant" to the disposition of the appeal. 911 F.2d at 964 n. 4.

In *Westinghouse*, the only questions presented on appeal were whether the one-year/three-year limitations periods for claims brought under § 10(b) also applied to claims brought under § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a), and whether the court's prior holding in *Data Access* should be applied retroactively. 993 F.2d at 350. The court expressly declined to address the issue of whether only actual notice was required to commence the running of the limitations period governing the investors' claims. The court stated that it "will be for the district court, and not us, to

consider in the first instance the application of our holding to the relevant facts before it." *Id.* at 356.

Moreover, in *Westinghouse*, the Third Circuit cited with approval the Seventh Circuit's decision in *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887, 115 L. Ed. 2d 1052 (1991), and the Second Circuit's decision in *Ceres Partners v. GEL Assocs.*, 918 F.2d 349 (2d Cir. 1990), as "adopt[ing] the result and reasoning we announced in *Data Access*." 993 F.2d at 352 n. 1. In *Short*, the Seventh Circuit borrowed § 13's limitation periods, the one year prong of which by its own terms runs from inquiry notice. 908 F.2d at 1390-91. In *Ceres*, the Second Circuit borrowed the 1934 Act's one-year/three-year periods under §§ 9(e) and 18(a), which it also found to run from inquiry notice. 918 F.2d at 364. *See Menowitz*, 991 F.2d at 41 ("The 1934 Act limitations period adopted in *Ceres*, and later adopted in *Lampf*, requires that claims be brought within one year of discovery of the facts giving rise to the violation. We have previously stated that 'discovery' under the 1934 Act limitation provisions includes constructive or inquiry notice, as well as actual notice." (citations omitted)).

That the Third Circuit has not definitively addressed this issue is confirmed by the post-*Gruber* and post-*Westinghouse* decisions of district courts within the Third Circuit that continue to apply an inquiry notice standard to § 10(b) claims. Indeed, after *Gruber*, the Third Circuit affirmed without opinion a district court decision expressly holding that inquiry notice is the proper standard under § 9(e). *See Manning v. Maloney*, 787 F. Supp. 433, 436 (M.D. Pa.), *aff'd*, 980 F.2d 722 (3d Cir. 1992). *See also Rolo v. City Investing Co. Liquidating Trust*, 1994 WL 14474, at *56 (D.N.J. Jan. 19, 1994) (Under the one-year limitation provision set forth in *Data Access* the "discovery need not be

actual; 'discovery' under the 1934 Act limitation provisions includes constructive or inquiry notice." (citations omitted)); *Kress v. Hall-Houston Oil Co.*, RICO Bus. Disp. Guide (CCH) ¶ 8348, at 14598, 1993 WL 166274 (D.N.J. May 12, 1993) ("[T]he *Lampf* rule does not require actual knowledge of the alleged wrong to trigger the running of the statute of limitations. Rather, 'the time to file suit begins to run when the investor either knows or in the exercise of reasonable diligence could have discovered the facts on which the suit is based.' *Norris v. Wirtz*, 818 F.2d 1329, 1334 (7th Cir.), *cert. denied*, 484 U.S. 943, 108 S. Ct. 329 (1987).").

Thus, no conflict has been created by the Third Circuit because the Third Circuit has never expressly held that discovery under the one-year prong of § 9(e) only runs from actual notice. Moreover, the Seventh Circuit's decision in this case is fully consistent with decisions of the Second, Fourth, Fifth and Tenth Circuits, and there is no conflict between those Circuits and any other Circuit on this issue.

CONCLUSION

For all the foregoing reasons, Respondents respectfully request that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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STATUTES INVOLVED

Section 9(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(e), provides that

> Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant. Every person who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment. No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides that

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange
>
> * * *
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contradiction of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.